APPENDIX A: VALUATION OF OTHER PROPERTIES

A-1 REAL ESTATE OWNED (REO)

HUD's Real Estate Owned (REO) properties are a result of paying a claim to a lending institution and the lender transferring ownership of the property to HUD. Typically, REO properties were owned by the lender because the borrower defaulted on the mortgage.

The appraiser must coordinate a specific time for a full site inspection of the property with the property manager. Generally, REO property is secured with the utilities turned off. However, the appraiser should attempt to have the utilities turned on to examine all building systems during the appraisal.

A. Appraiser Requirements

Requirements for appraisers who perform REO appraisals are the same as for appraisers of any other property. An appraiser of REO property must be state licensed and be a current member of the FHA Register.

B. Appraisal Requirements - "As-Is" Value

REO properties are to be appraised "as-is". *The Dictionary of Real Estate Appraisal*, third edition, defines "as-is" market value as follows:

> "The value of specific ownership rights to an identified parcel of real estate as of the effective date of the appraisal; relates to that which physically exists and is legally permissible and excludes all assumptions concerning hypothetical market conditions or possible reasoning."

The "as-is" value is the market value for the property as it exists **on** the date of the appraisal.

The appraisal shall consist of the Uniform Residential Appraisal Report (URAR) and the Valuation Conditions (VC) form. The appraiser shall indicate on the appraisal or an addendum to the appraisal if the property can be sold with FHA mortgage insurance (meets FHA minimum property requirements) either (1) in its as-is condition without repairs or (2) in its as-is condition with repairs costing $5,000 or less. If the property can be sold with FHA mortgage insurance by making $5,000 or less in repairs, the appraiser shall provide a list of the repairs and their estimated cost. If the property needs more than $5,000 in repairs to make it eligible for FHA mortgage insurance, the appraiser needs only to list the general areas of repairs and provide a statement that such repairs will exceed $5,000.

C. Effective Date of Value

The effective date of value is the date when the appraiser performs the site visit for the subject property. If another date is used as the effective date, the appraiser must specifically indicate:

- the alternative date
- the date when the subject property was physically inspected

D. Scope

(A-1) The appraiser must perform the complete appraisal process, which includes considering all applicable approaches to value and developing appropriate approaches identified in this Handbook.

E. Purpose

The purpose of the REO appraisal is to help establish the sales price for the subject property. REO appraisals will estimate the "as-is" value of a foreclosed property owned by HUD.

F. Intended Use of Appraisal/Function

The intended use or function of a REO appraisal is to provide the "as-is" value of foreclosed property for marketing and bidding purposes. Great reliance will be placed on the as-is value of the property for future sale. The as-is value supports FHA's sales price for the disposition of the property. The extent of repairs needed to the property will determine if it is offered for sale with FHA-insured financing or without insured financing. If the property meets minimum FHA property requirements without repairs, or meets FHA minimum property requirements with $5,000 or less of repairs, the property will be offered with FHA insured financing. If required repairs exceed $5,000, the property will be offered without Section 203(b) insured financing, but eligible for Section 203k insured financing.

G. Additional Requirements

The appraiser must value the subject property from the information gathered and arrive at an estimated market value of the subject property based on the requirements detailed in Chapter 4—Valuation Analysis—of this Handbook.

Include all transaction data of the previous homeowner, date of that transaction and sale prices based on USPAP requirements. This provides a benchmark or frame of reference for the property and neighborhood market conditions.

For properties where the interior cannot be inspected because of adverse occupants or other reasons, estimate the value based on an exterior inspection of the property. *Use the Freddie Mac 704 form, Second Mortgage Property Value Analysis Report, in conducting exterior estimates of value.* Prepare a narrative report on the outside condition and the apparent maintenance of the property in contrast to the neighborhood properties. Include the estimate of value and include photographs of the exterior, as well.

A building sketch is required, but a floor plan or room layout of the property is not required.

The appraiser must consider and note the exposure period and estimate how long the property is expected to remain on the market. The exposure period differs from the marketing period. The exposure period estimates the length of time the property interest would have been offered on the market before the effective date of the appraisal. The concept of reasonable exposure encompasses not only adequate, sufficient and reasonable time but also adequate, sufficient and reasonable effect. The Valuation

Analysis must be based upon a Reasonable Exposure Period.

When appraising REO properties, the appraiser must adhere to all other valuation and appraisal requirements discussed in previous chapters.

A-1.1 Approaches To Value

A. Cost Approach

Generally, the Cost Approach is not developed for REO properties. If the Cost Approach is justified, follow the specifications outlined in Chapter 4: Valuation Analysis. The appraiser is required to quantify repair costs in depreciation for an "as-is" value.

B. Sales Comparison Approach

Often, the Sales Comparison Approach is the most applicable approach to estimate the market value of a REO property. Appraisers must utilize sales comparables from other REO transactions from HUD, the Department of Veterans Affairs, Fannie Mae, Freddie Mac, or a conventional lender, as long as they include the following requirements:

- in the subject neighborhood or reasonable proximity
- comparable property subject to reasonable adjustment
- sold with a willing buyer and seller
- exposed to the market for a reasonable period

If comparables such as these are not available, regular market comparables may then be used.

Do not use distressed sales such as Sheriff Sales in the Sales Comparison Approach. These sales do not involve a willing seller nor are they exposed to the market under normal conditions. The resulting value indication derived from the use of such sales is not consistent with the definition of market value. Always use the sales comparison approach for one- and two- unit properties.

This approach relies on:

- the availability of sales data
- the volume of transactions
- the mirroring of Sales Comparison Approach
- the market
- the ability to observe and report the most recent market trends

Data confirmed and developed under this approach has direct application to the other approaches used and should be considered therein. At least three comparable sales must be used with this approach. At all times, the appraiser must carry forth the assumptions and data from the other approaches and the VC form in developing a value estimate by the Sales Comparison Approach.

C. Income Approach
Generally, the Income Approach is not developed for one- or two-family REO properties. If the market indicates that the Income Approach is justified, follow the specifications outlined in Section 5: Valuation Analysis. For three- and four-unit properties, always use the income approach.

A.1.2 Reporting Requirements
An REO appraisal must be performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP).

Other reporting requirements are as follows:

- With each appraisal, the appraiser must provide a list of any buyer incentives that would enhance the marketability of the property to provide an incentive to buy the property un-repaired as opposed to repaired.
- For all property constructed before 1978, the appraiser must condition the appraisal on the completion of a lead-based paint test.
- For appraisals of vacant lots (land), complete Form FW 68, Land Appraisal Report, or an equivalent form.

A-1.2 Reconciliation
The final analytical step in the valuation process is to reconcile value indicators. In this step, the appraiser must measure the strengths and weaknesses of each applicable approach and develop this data into a single value estimate.

A-2 APPRAISAL OF SINGLE FAMILY HOMES ON NATIVE AMERICAN LANDS
For purposes of this appraisal guidebook, if a lender specifically needs an appraisal under HUD/FHA's Section 248 program on Tribal Trust land or for HUD's Office of Native American Program (HUD/ONAP) Section 184 on Tribal Trust, allotted (which is also known as individual trust) and fee simple lands, these guidelines will apply. If the property is on allotted (or individual) trust or fee simple land located on Native American Reservations and it will be mortgaged under HUD/FHA's Section 203(b), the appraiser must use the basic appraisal methodology addressed in this handbook.

Within designated Native American Reservations, treaties and tribal laws have created a variety of ownership patterns. Some parcels may be unrestricted fee simple, other parcels restricted tribal trust or allotted trust land. The appraiser must be familiar with the different restrictions and develop a reasonable value for the subject property. Following are the general designations.

A. FEE SIMPLE UNRESTRICTED
Fee simple unrestricted ownership is ownership real property which may be bought, sold and transferred between Native American or non-Native American purchasers without review by the Tribe or Bureau of Indian Affairs, (BIA). For the HUD/ FHA

Section 203(b) program, appraisals must conform to all other standard HUD appraisal policies. For the HUD/ONAP Section 184 program, fee simple land on a reservation, the procedures utilized for tribal trust and allotted trust may be followed.

Restricted Trust Land is land held by an individual Indian or Tribe which is subject to Federal restriction against alienation or encumbrance. Before any lien can be placed against restricted land, the transaction must be approved by the Bureau of Indian Affairs (BIA). All HUD loans must comply with this requirement and provide evidence in the HUD loan file. Lenders are encouraged to make contact with the appropriate BIA and Tribal realty officers early in the loan processing.

B. TRIBAL TRUST

Tribal trust lands are held in trust for the tribe by the United States government. Tribes may lease portions of the tribal trust land for the use of specific individuals, but ownership, through the Federal trust, remains with the tribe.

C. ALLOTTED (OR INDIVIDUAL) TRUST LAND

Land owned by individual tribal members but held in trust by the United States government. It is common for allotted trust lands to be owned by several individuals. If a prospective borrower proposes to use all or a portion of a fractionated property, all other owners must indicate acceptance of this arrangement by becoming parties to the mortgage or subdividing the subject parcel out to the individual for undivided ownership.

A-2.1 PROPERTY RIGHTS APPRAISED

A. TRIBAL TRUST LAND

HUD/FHA's Section 248 insures mortgages and HUD/ONAP's Section 184 guarantees mortgages on homes that are located on Native American Tribal Trust Land. For these properties, leased ownership of the underlying land remains with the tribe and will be subject to a long-term 50 year ground lease (or a 25 year lease with a 25 year renewable term). Determining the value for the leasehold estate is the purpose of the appraisal and the subsequent use is to provide supporting documentation for a HUD insured or guaranteed mortgage. Mortgages on tribal trust sites must include an acceptable lease signed by the mortgagor and Tribal authority and approved by the BIA.

B. ALLOTTED (OR INDIVIDUAL) TRUST LAND

Mortgages on allotted (or individual) trust sites do not involve a lease, but a specific mortgage rider is required. All HUD loans must have a Deed of Trust Rider attached approving the mortgage pursuant to 25 USC 483 (a) and approved by the BIA.

HUD/ONAP's Section 184 guarantees mortgages on allotted trust land. Allotted trust land is held in trust by the federal government for individual Native Americans. The land is owned by the individual and value is given for the land. When appraising allotted trust land for Section 184, appraisers may follow the method given for Tribal Trust Land.

HUD/FHA insures mortgages on homes that are located on allotted trust land under Section 203(b). The appraiser can use this data for background information, but must use the typical appraisal practices for FHA Section 203 addressed in Chapters 3 and 4 of this handbook.

The appraiser must perform the complete appraisal process according to current USPAP and HUD/FHA standards. This includes consideration of all applicable approaches to value and complete development of all applicable approaches, as identified herein.

A-2.2 APPROACHES TO VALUE

The appraiser must be familiar with the different restrictions and develop the appropriate value for the subject property. The supply of comparable sales and rental transactions vary by location and by tribes. Until sufficient sales exist on a reservation or within the specific Native American area to provide a reasonable sales comparison approach for determining the value of tribal trust leaseholds or allotted land sales, the appraiser must rely on other value indicators. The appraisal process must be documented more thoroughly than a typical market appraisal. USPAP Standards #1 and # 2 are effective to allow the appraiser to “correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal.” And “in reporting the results of a real property appraisal an appraiser must communicate each analysis, opinion and conclusion in a manner that is not misleading.” An appraisal on trust land may rely more on the cost approach, or data developed from other tribes. HUD will accept the report if the appraiser has documented the search, information developed and conclusions clearly for the intended users to understand.

A. Cost Approach

The cost approach is often the primary indication of value based on the unique nature of the reservation setting. In conjunction with the completion of this approach on tribal trust sites, the value of the site as vacant does not apply. On the cost approach addenda to the URAR the value of the site is zero or a small leasehold value. If the land lease is at market and there was no upfront payment the lease-fee value is equivalent to the leasehold value, which is zero. This is the typical scenario and no value exists for the underlying land. The appraiser should enter the statement “subject is on Tribal Trust Land with annual rent not capitalized" in comments. If a market exists and the land was purchased, the value is estimated via traditional methods.

1. New Construction

Due to the flexibility allowed by law, HUD permits the inclusion of development costs for new construction, which can exceed market value, to be used in both Section 248 and Section 184. Following are instructions specific to new construction on tribal lands. The basic appraisal methodology is addressed in Chapter 4 of this handbook.

In addition to including the cost of water, septic, and any other on-site costs in the cost approach, for lands within the reservation, the appraiser may provide an allowance for off-site development costs. The lesser of actual pro-rated costs or up to 10% of the cost of the construction of the subject house may be added for off-site infrastructure associated with development of the subject lot. This policy applies principally to new construction where such charges are assessed by tribally approved entities such as housing entities or housing authorities, or agreements with other federal or local government bodies for providing power, utilities, sewer/water and/or road construction. The costs to bring utilities; including public water, sewer, electricity, and telephone represent significant development costs. The traditional tract development of residential homes may not be a part of the local culture. Therefore, the utility costs to hook-up to any form of a public system in a more rural area can exceed local standards.

(A-2.2)

In remote areas, the construction costs in the Marshall & Swift guide or related cost manuals may have to be adjusted for transportation, labor or other costs not included in the basic estimate. Architect fees are not typically reflected in the base building costs. Due to special circumstances the normal allocation for this fee may not automatically reflect the above actual cost. The appraiser must provide a supporting explanation in the adjustments to the construction costs.

2. Existing Construction

Where market sales are limited, HUD requires the cost approach to be completed on all tribal trust appraisals, including a credible estimate of depreciation.

B. Sales Comparison Approach

Native American communities are developing economies at varying rates and degrees. It is important for the lender and HUD to understand the economic factors which affect value. Therefore the appraiser must communicate the local tribal housing market. The sales comparison approach will generally be completed, and in remote areas may involve sales up to 18 months old. Where no credible comparables are available, a narrative justification that discusses the market, and provides any sales, rental or vacancy information pertinent to the subject will be acceptable to support value developed from the cost approach. In addition to the typical data sources the appraiser may obtain sales information from the local tribal or Bureau of Indian Affairs (BIA) realty office. Sales from other reservations within the region may be considered. Each situation will have unique factors and the appraiser should explain deviations from the sales comparison approach instructions outlined in Chapter 4 of this Handbook. The order of selection preferences for sales would depend on the type of land being appraised.

- Tribal Trust Leasehold sales (market sales between tribal members)
- Sales of allotted land trust between tribal members
- Fee Simple within the Reservation (residual value of the improvements by adjusting out the land contribution)
- Fee Simple proximate to the Reservation

For comparable sales that include land value, an adjustment is required to back-out the raw land value. This adjustment is required when comparing a fee simple comparable sale to a Native American trust sale transaction.

Enter adjustments on the form under "Other" and label as 'Raw Land Value," which is determined separately for each of the comparable sales.

C. Income Approach

The income approach is generally not developed with regard to Native American Trust Land. If the property includes a rental unit(s), the appraiser must provide an estimate of monthly rent for each unit and note whether or not the rent is limited to the tribal sub-market. If the appraiser determines that this approach is justified, the appraiser should complete the income approach according to the specifications outlined in Chapter 4 of this Handbook.

A-2.3 Reconciliation of Value

The appraiser must determine the market value for the restricted trust properties from the limited data available. Value determination on trust land is an exception to typical HUD/FHA instructions; value is not limited to the lower of cost or market. Where market information is limited, greater weight may be given to the replacement cost approach. Document the decision process and the value.

A-2.4 HUD/FHA REQUIREMENTS

On loans involving restricted trust land, with either Section 184 or Section 248, HUD waives the requirement of a strict interpretation of market value and will accept loans based on the above market cost approach. All other HUD health, safety, access, and property condition issues must conform to FHA requirements.

The appraiser must indicate if the property is in need of, or in the process of receiving any repairs. Make appropriate requirements for repairs to-be-completed and appraise the property "as repaired."

The appraiser must indicate if the property conforms to the applicable Minimum Property Requirements of this Handbook. If it does not, the appraiser must recommend correction of the deficiency or rejection of the loan and explain. Tribally owned and maintained streets and utilities are considered publicly owned. Appraisers must require easements and a maintenance agreement for non-public, common ownership situations.

HUD accepts tribal enforcement of building codes and inspections to the extent they are standard and enforced. At the point tribal support is not available, review and certification that the work complies with an appropriate national standard must be contracted out to a licensed or certified specialist. Example, a tribe issues building permits, but has no provisions for inspections. The lender/borrower must contract with a lender approved qualified specialist such as an engineer, architect or inspector. Inspection/approval by the Indian Health Service is acceptable for individual or community water and sewer systems.

The remaining economic life must be estimated and reported but does not limit the mortgage. The subject property must possess sufficient remaining physical life to warrant a long-term mortgage. The mortgage term may not exceed the remaining physical life of the property.

A. HUD/FHA Section 248 and HUD/ONAP Section 184 Requirements

For both Section 248 and Section 184 programs, the property must be free of hazards, noxious odors, grossly offensive sights or excessive noises which might endanger the physical improvements, affect the livability of the property, its marketability, or the health and safety of its occupants. If any of these conditions exist, the appraiser must recommend correction of the problem or rejection of the loan and explain.

For both programs, the appraiser will make appropriate requirements to correct any observed or potential environmental problems. Many reservations have not been mapped for the 100-year flood plain. If the appraiser observes a possible flood plain problem, they are to require flood insurance on existing properties. The Underwriter may waive the flood insurance requirement if the borrower or the tribe provides an elevation certificate from a licensed engineer that the property is not at risk from flooding. Note that the lowest floor (including basement) for new construction must be at or above the 100-year flood elevation.

B. REPORTING REQUIREMENTS

The appraiser must report if an approach was not developed and insert the rationale for exclusion of the approach. The appraiser must attach an addendum complete with the assumptions supporting the indication of value by the cost approach. The cost approach is reconciled to the other values, if any, on the URAR. The appraiser will indicate any work requirements or VC pursuant to outstanding instructions. The DE underwriter/lender must assure acceptable completion of any work requirements pursuant to existing instructions.

A-2.5 INSTRUCTIONS FOR ASSISTED APPRAISAL PROCESSING IN APPRAISAL HIGH COST AREAS

To accommodate the special conditions associated with remote locations on Native American lands, the following assisted appraisal process is allowed.

The assigned appraisers may network with local personnel where the high cost of real estate appraisals is a concern for underwriting single family mortgages in Native American communities. To minimize this problem, FHA and ONAP will allow the use of trained local personnel to perform the inspection, provide current analysis of the local market, and draft the appraisal report. The report must be forwarded to the assigned appraiser who will review the report, provide additional documentation, sign the URAR and forward the report to the lender.

Using the Assisted Appraisal Process is restricted to remote areas where licensed appraisers are not readily available. It may be used when the cost of transportation and/or time increases the cost of the appraisal to twice the cost of typical appraisals in the local urban areas. The process must be monitored and acceptable to the DE underwriter/lender. The assigned appraiser may use local subcontractors who:

- Have general real estate skills (construction, lending, sales, management) acceptable to the appraiser (such as Housing Authority staff, Tribal Designated Housing Entities (TDHE) staff or BIA realty personnel, local real estate professionals).
- Must comply with the Conflict of Interest limitations (have no personal or financial interest with the buyers or sellers of the property).

- An appraiser who signs a real property appraisal report prepared by another, even under the label of “review appraiser” must accept full responsibility for the contents of the report, USPAP Standard 2-5.

- The assigned appraiser is responsible for the entire appraisal and signs the URAR. The individual assisting in the report must document the extent of help provided and certify no conflict of interest exists in the certification.

- The assigned appraiser must be familiar with the Competency Rule in the USPAP. This includes key issues such as the unique property rights conveyed, the local market involved and market conditions. It is assumed the remote area markets will change slowly. If conditions have changed, an updated analysis is required. The assigned appraiser assumes all responsibility that the appraisal meets all HUD/FHA and ONAP program requirements.